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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 906

ROVICO, INC., PETITIONER,

against

AMERICAN PHOTOCOPY EQUIPMENT COMPANY,
RESPONDENT.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

In its statement of questions 1 through 5, petitioner has assumed facts directly contrary to the findings of the courts below.

Restating these questions to conform to the findings:

1 (former 1-3). Is a uniform royalty of 6% of the retail selling price of a machine so "exorbitant and oppressive" as to constitute misuse of the patent licensed when an entire business was founded on the invention of the patent and the total royalties constitute less than 2% of the sales resulting from that business?

2 (former 4). Is a patent misused by charging a royalty computed on the selling price of a com-

plete machine of which a major and functionally indispensable segment is covered by the patent?

3 (former 5). Was it error to exclude a deposition taken in another action between different parties, where the deposition was inadmissible even in the action in which it was taken (due to the arbitrary refusal of the witness to permit completion of his cross-examination) and where a deposition exhibit (a letter written by the witness himself) contradicts petitioner's statement as to what the deposition would show?

Petitioner's statement of the remaining Question 6 gives a misleading impression of the relevant facts, as discussed hereinafter.

STATEMENT OF FACTS

In its statement of facts, petitioner asserts at page 10 that the exposure and developer mechanisms are "separate machines" each of which "performs its own function independently of the other."

That statement is highly misleading. The record shows not only that the two mechanisms share the same cabinet, the same motor and drive mechanism, and the same electrical supply and control components, but also that neither mechanism is of any significant utility without the other. The following testimony of the witness MacLeod was uncontradicted:

"I want to make it clear that you cannot practice transfer diffusion photocopying without both exposure and developing. One unit is no good with-

out the other." (Appendix to Appellee's Brief, 100b)

At pages 10 and 12, petitioner asserts that "the patent dominates the industry" and that "respondent and its licensees comprise the bulk of the industry." On the contrary, following the trial on the merits, the District Court found that the patented DTR machines

> "... account for only 10 per cent of the photocopying machine market, of which plaintiff's (respondent's) sales amount to 15 per cent or 1½ per cent of the total." (A 25-26)

Thus the Court found that

> "... the bulk of the office photocopying industry is not involved." (A 30)

The Court of Appeals, upon review of the trial record, affirmed these findings (A 43).

There were two hearings before the Seventh Circuit Court of Appeals involving the parties herein. The first was to review the District Court's granting of a preliminary injunction and resulted in a decision dated March 3, 1966. The second was to review the lower Court's disposition of the case on the merits and resulted in a decision dated August 22, 1967. Petitioner bases its assertion that the patent in suit dominates the industry and that respondent and its licensees comprise the bulk of the industry on a finding by the Court of Appeals in its earlier opinion of March 3, 1966 (A 10). But petitioner fails to mention anywhere in its lengthy petition that this decision of March 3, 1966 (on the interlocutory appeal from the prelimi-

nary injunction) was not based upon any record except the allegations of petitioner's counterclaim, which the Court found were not properly challenged, and an affidavit of petitioner's president which was abandoned when he did not testify at the trial, though present.

Before the Court of Appeals, in the hearing which preceded its second decision of August 22, 1967, petitioner took the position that the Court of Appeals, in its March 3, 1966 opinion, had already decided these misuse issues in its favor. But the Court of Appeals, in its August 22, 1967 decision, expressly rejected that contention, pointing out that its earlier decision was based merely upon the "undisputed" allegations of the counterclaim, and was not a decision on the merits. Petitioner's reliance upon the finality of the earlier decision was regarded by the Court of Appeals as a "principal weakness" in petitioner's position on the second appeal (A 43).

Having thus been corrected by the Court of Appeals as to the meaning and effect of its March 3, 1966 decision, petitioner has nevertheless repeated the same discredited assertions to this Court, just as though the Court of Appeals had never rendered its later decision on the merits.

REASONS FOR NOT GRANTING THE WRIT

I. Alleged "exorbitant and oppressive" royalties.

Petitioner argues, at pages 12-16, that this Court should settle the question "whether the leverage of a patent may be used to exact exorbitant and oppressive patent royalties."

There are two fallacies in that argument:

1. In the first place, this Court has already resolved this issue. In *United States* v. *General Electric Co.*, 272 U. S. 476, 489 (1926), the Court stated:

> "... the patentee may grant a license to make, use and vend articles under the specification of his patent *for any royalty* or upon any condition the performance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure." (Emphasis added)

In *United States* v. *Huck Mfg.*, 382 U. S. 197 (1965), this Court affirmed without opinion a decision of the Court of Appeals for the Ninth Circuit quoting and following the foregoing language from *General Electric.*

And in *Brulotte* v. *Thys*, 379 U. S. 29, 33 (1965), this Court emphatically and unequivocally restated the principle:

> "A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly."

It is difficult to imagine how this statement could leave any lower court with the impression that it has the right, much less the duty, to reopen every patent license negotiation and form its own judgment as to whether the licensee agreed to pay more than the license rights were really worth.

The lower courts have obviously gotten this message, for petitioner is unable to cite a single decision in which the amount of the royalty charged, however high, has

been ruled to constitute a patent misuse. As stated in *Stearns* v. *Tinker & Rasor,* 252 F.2d 589, 605 (9 Cir. 1957):

> "To say that the mere amount of money due and payable for the grant of a license is subject to judicial review would render each and every agreement subject to court approval. No cases have gone that far."

2. In the second place, if the law really needed clarification as to whether "exorbitant and oppressive" patent royalties are illegal, the present case is not the proper vehicle therefor, since the courts below made concurrent findings that, under the circumstances here, there was "no unreasonableness" in the royalty charged (A 27; A 42-43).

Among the factors cited by the District Court in ruling the royalties reasonable were:

> (1) the patent owner itself paid, for its own operations under the patent, an amount equal to twice the royalty paid by its licensees for the same rights of manufacture and sale (A 27);
>
> (2) the licensee pays no royalty on its sales of paper and chemicals which are generated by use of the licensed machines which it has sold, and since these supply sales average as much as three times the machine sales (Appendix to Appellee's Brief, 108b), the royalty actually amounts to less than 2% of the total sales which the patent makes possible (A 27); and
>
> (3) the prices of the licensed machines actually declined after the licenses were granted (A 27).

The latter fact makes petitioner's argument, at pages 18-20, that excessive royalties have the effect of "price fixing" seem wholly incongruous.

Petitioner's reliance at page 18 on this Court's dictum in *Standard Oil Co. (Indiana)* v. *United States,* 283 U. S. 163, 174 (1931) is similarly misplaced, since that statement specifically referred to a situation in which "combining patent owners effectively dominate an industry."

Here there are no combining patent owners and the lower courts expressly found that "the bulk of the office photocopying industry is not involved." (A 30).

II. Alleged derivation of royalties from "unpatented machines."

Petitioner argues at pages 20-24 that respondent is charging a royalty on "unpatented machines" and that this violates the principle enunciated by this Court in *Mercoid Corp.* v. *Mid-Continent Investment Co.,* 320 U. S. 661 (1944).

There are two fatal defects in that argument:

1. To begin with, respondent has never charged a royalty on unpatented machines. The royalty is payable only on machines which incorporate the patented developer mechanism. Where the exposure and developer mechanisms are sold as separate units, the royalty is payable only on the latter (Appendix to Appellee's Brief, 100b-101b). Where the licensee elects, for reasons of economy of manufacture, compactness and operating convenience, to combine both mechanisms in a single machine, the royalty is computed, for purposes

of simplicity and certainty, on the selling price of the entire machine. The Court can readily appreciate the disputes which would result from attempting to base the royalty only on the "patented" portion of the machine, since this would involve apportioning to the patented and unpatented portions indeterminate fractions of the value of the common elements, such as the cabinet and motor, which serve both portions.

But, as the District Court observed:

> "Whether the royalty is stated as 6 per cent of the retail price of the entire machine, including the non-patented device, or 12 per cent of the retail price of the Eisbein apparatus alone is not essential, for the result is precisely the same . . . a specified charge for the right to manufacture under the patent at issue." (A 28).

2. Moreover, *Mercoid* does not rule that a royalty cannot be charged on a machine containing unpatented elements. Instead that case involved the entirely different situation where the owner of a patent on a heating control system refused to license the patent except to those who agreed to purchase from it the unpatented switches used in the patented system. Since this practice tended to give the patentee a monopoly in the sale of the unpatented switches, this Court ruled it an illegal extension of the patent monopoly.

Here respondent has not given the purchaser of any unpatented element a free license under the patent, nor has it done anything else which tends to extend its patent monopoly.

Its licensing practice is far more innocuous than that which this Court approved in *Automatic Radio*

Mfg. v. *Hazeltine Research,* 339 U. S. 827, 834 (1950), where the licensee was required to pay royalties computed as a percentage of its entire sales of television receivers, whether patented or not. This undoubtedly resulted in payment of royalty on some wholly unpatented units. And it is quite significant that this Court expressly distinguished such royalty provisions from the illegal extension of monopoly proscribed by *Mercoid.*

A fortiori, the *Mercoid* principle does not apply to the present situation, where a royalty is payable only on machines of which a major and functionally indispensable segment is patented.

III. The exclusion of the Boeger deposition.

Petitioner argues, at pages 24-28, that the District Court committed reversible error in excluding from evidence the deposition of a Dr. Boeger, taken in a previous action for infringement of the Eisbein patent brought against respondent by Copease Manufacturing Co. Inc., respondent's predecessor in title to the patent.

The thrust of petitioner's argument is that although respondent was involved in the previous action as a *defendant* accused of patent infringement, and thus was on the side of the case opposite to its present posture, its predecessor in title was the plaintiff there and had the same motive in cross-examination as respondent now has.

However, petitioner curiously omits to mention that the Boeger deposition was not even admissible in the action in which it was taken (and was not even offered) because Boeger arbitrarily refused to permit comple-

tion of his cross-examination (Boeger dep., pp. 51, 52). *A fortiori* it is inadmissible in the present action.

Moreover, petitioner's statement at pages 24 and 25 that the Boeger deposition would show that Boeger had designed a machine "identical" with the patented Eisbein machine "either prior to, or contemporary with, the Eisbein machine," is contradicted by Exhibit 42 to the deposition (Appendix to Appellee's Brief, 147b) which shows conclusively that Boeger did not design his machine until after he had thoroughly inspected the Eisbein machine and seen it operated, had extravagantly praised it, and had even ordered 25 of the Eisbein machines for his own company and 8 more for another company on his own initiative. It is no mere coincidence that the machine which Boeger subsequently designed was "identical" to the Eisbein machine.

In characterizing the Boeger deposition as "crucial" evidence, petitioner has been intemperate, to say the least.

IV. Respondent's alleged "unclean hands."

Petitioner has grossly misstated the circumstances and terms of the unaccepted "offer" which was made to petitioner's employee in connection with his proposed testimony. The facts are correctly stated in the affidavit which was filed in the District Court and which is reproduced as Appendix A to this Brief.

As this affidavit clearly shows, there was no offer of valuable consideration "for or because of the testimony" of the employee, as prohibited by 18 U.S.C. § 201.

CONCLUSION

The petition should be denied.

Respectfully submitted,

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